ST 03-0114-GIL 07/15/2003 COMPUTER SOFTWARE

A transaction involving the licensing of software will not be considered a taxable retail sale if such transaction meets all the criteria listed in subsection (a)(1)(A-E) of Section 130.1935. See 86 Ill. Adm. Code 130.1935(a)(1) (This is a GIL.)

July 15, 2003

Dear Xxxxx:

This letter is in response to your letter dated April 30, 2003. The information you have provide require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See, 2 Ill. Adm. Code 1200.120 subsections (b) and (c), which can be found at http://www.revenue.state.il.us/Laws/regs/part1200.

In your letter you stated and made inquiry as follows:

I am requesting that your department review our software license agreement, which I have enclosed, and provide us with a determination, in writing, as to whether our software qualities as **not** taxable under the Illinois Department of Revenue Regulations, Title 86: Revenue, Part 130, Retailers' Occupation Tax, Section 130:1935 Computer Software a), 1), A-E.

We were originally told by the Illinois Department of Revenue that software is taxable because it is tangible property. There was no questions asked by the Illinois Department of Revenue and no differentiation was made as to kinds of software or how it is sold. But it appears from the enclosed document (referenced above) that our software is, in fact, not taxable. We have a signed contract with all of our clients.

I also need a determination, in writing, as to whether our software maintenance is **not** taxable. It is my understanding that if the software is not taxable, then the maintenance is not taxable.

We have several clients in Illinois that I will have to refund sales tax we have collected and remitted to the state before I can file an Amended Sales and Use Tax Return. Prior to doing that, I would like a determination in writing by the Illinois Department of Revenue, so there is no dispute at a later date.

If you have any questions, please call between the hours of 8:30 am and 5:30 pm, Monday through Friday.

I will greatly appreciate your assistance in this matter.

The Illinois Retailers' Occupation Tax Act imposes a tax upon persons engaged in this State in the business of selling tangible personal property to purchasers for use or consumption. See 86 Ill. Adm. Code 130.101. Illinois imposes a Use Tax on the privilege of using in this State any kind of tangible personal property that is purchased anywhere at retail from a retailer. See 86 Ill. Adm. Code 150.101. If a sale does not involve the transfer of tangible personal property to the purchaser, then the Illinois Retailers' Occupation and Use Taxes do not apply.

Canned software is considered tangible personal property regardless of the form in which it is transferred or transmitted, including tape, disc, card, electronic means or other media. The sale at retail, or transfer, of canned software intended for general or repeated use is taxable, including the transfer by a retailer of software which is subject to manufacturer licenses restricting the use or reproduction of the software. Charges for updates of canned software are also considered to be sales of software. Please refer to the enclosed copy of 86 Ill. Adm. Code 130.1935.

The tax applies to the entire charge made to the customer, including charges for all associated documentation and materials. Charges for training, telephone assistance, installation and consultation are exempt if they are separately stated from the selling price of the canned software.

According to your letter and the attached copy of AAA's License and Service Agreement, AAA sells perpetual limited licenses to use its software products. A transaction involving the licensing of software will not be considered a taxable retail sale if such transaction meets all the criteria listed in subsection (a)(1)(A-E) of Section 130.1935. If all such criteria are met, then neither the transfer of software nor the subsequent software updates will be subject to Retailers' Occupation and Use Tax. Section 130.1935(a)(1) states that a license of software is not a taxable retail sale if:

A) It is evidenced by a written agreement signed by the licensor and the customer;

B) It restricts the customer's duplication and use of the software;

C) It prohibits the customer from licensing, sublicensing or transferring the software to a third party (except to a related party) without the permission and continued control of the licensor;

D) The licensor has a policy of providing another copy at minimal or no charge if the customer loses or damages the software, or of permitting the licensee to make and keep an archival copy, and such policy is either stated in the license agreement, supported by the licensor's books and records, or supported by a notarized statement made under penalties of perjury by the licensor; and

E) The customer must destroy or return all copies of the software to the licensor at the end of the license period. This provision is deemed to be met, in the case of a perpetual license, without being set forth in the license agreement.

In the context of a General Information Letter, the Department cannot give you a binding ruling as to whether the attached license agreement meets the requirements of Section 130.1935. However, after review of your licensing agreement it appears that the licensing of computer software by AAA to its customer in accordance with such licensing agreement does not meet all the requirements for treatment as an exempt license. As such, neither the transfer of the software nor the subsequent updates of the licensed software would be considered exempt, making the transaction a retail sale subject to tax.

In reviewing the attached license agreement, it does appear that the agreement meets the requirements of Section 130.1935(a)(1)(A), (B), (C) and (E). However, the agreement does not explicitly state that AAA has a policy of providing another copy of the software at minimal or no charge if the customer loses or damages the software, or of permitting the licensee to make and keep an archival copy. The requirement in Section 130.1935(a)(1)(D) can also be met by supporting books and records or by a notarized statement made under penalties of perjury by the licensor to the licensee that such is the policy. Without more information showing that AAA's replacement policy meets the requirements of Section 130.1935(a)(1)(D) we must conclude that transfers of AAA's software under such licensing agreement would be subject to Retailers' Occupation Tax and Use Tax.

Generally, maintenance agreements that cover software are treated in the same manner as other maintenance agreements for other types of tangible personal property. The taxability of maintenance agreements is dependent upon whether the charges for the agreements are included in the selling price of the tangible personal property. If the charges for the maintenance agreements are included in the selling price of tangible personal property, the charges are part of the gross receipts of those retail transactions and are subject to tax. No tax is incurred on the maintenance services or parts when the repair or servicing is completed.

If maintenance agreements are sold separately from tangible personal property, the sales of those agreements are not taxable transactions. However, when maintenance services or parts are provided under such maintenance agreements, the service or repair companies will be acting as service providers under the Service Occupation Tax Act. The Service Occupation Tax Act provides that when service providers enter into agreements to provide maintenance services for a particular piece of equipment for a stated period of time at a predetermined fee, those service providers incur Use Tax based upon their cost price of tangible personal property transferred to the customers incident to the completion of the maintenance services. See part (3) of subsection (b) of the enclosed copy of 86 Ill. Adm. Code 140.301.

It must be noted that charges for updates of canned software are fully taxable pursuant to Section 130.1935. If the agreement provides for updates of canned software and the updates are not separately stated and taxed, the entire maintenance agreement constitutes a sale of canned software and is subject to tax.

In reviewing the license agreement, it appears that the charge for maintenance and service is included with the transfer of software, and is not sold separately from the software. Therefore, the charges for maintenance and support would be considered part of the gross receipts from the retail sale of the software and subject to tax. Additionally, I would also like to point out that AAA's maintenance agreement would still be considered subject to tax even if it were sold separately from the sale of software. The maintenance agreement contains provision for updates of the canned software not separately stated and taxed from the agreement, making the entire maintenance agreement a sale of canned software.

As stated above, the Department cannot give you a binding opinion in the context of a General Information Letter. You may, however, request a Private Letter Ruling asking for a binding ruling regarding your license agreement and submit the additional information necessary to make a determination.

I hope this information has been helpful. The Department of Revenue maintains a Web site, which can be accessed at www.state.il.us. If you have further questions related to the Illinois sales and use tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in item 1 through 8 of Section 1200.110(b). Such regulation may be obtained from our Web site mentioned above at http://www.revenue.state.il.us/Laws/regs/part1200.

Sincerely,

Dana Deen Kinion
Associate Counsel

DDK:msk